DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 04-20120003
Sales and Use Tax
For Tax Years 2008, 2009, and 2010

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ISSUES

I. Sales and Use Tax–Software Maintenance Agreements.

Authority: IC § 6-2.5-1-1; IC § 6-2.5-1-27; IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-8.1-5-1; IC § 6-8.1-3-3; 45 IAC 2.2-4-1; 45 IAC 2.2-5-26; Sales Tax Information Bulletin 2 (December 2006); Sales Tax Information Bulletin 8 (May 2002); Letter of Findings 05-0438 (August 11, 2006); Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Carroll County Rural Elec. Mem. Co-op. v. Indiana Dep't of State Revenue, 733 N.E.2d 44 (Ind. Tax Ct. 2000).

Taxpayer protests sales tax assessments on certain sales of software and software maintenance agreements.

II. Sales and Use Tax–Streamlined Sales Tax.

Authority: IC § 6-2.5-11-2; IC § 6-2.5-11-10; Commissioner's Directive 27 (July 2005); Streamlined Sales and Use Tax Agreement (adopted 2002 and amended through December 13, 2010); Contract between Streamlined Sales Tax Governing Board, Inc. and [CSP] (June 2008).

Taxpayer asserted that reliance on third party service provider in conjunction with Streamlined Sales and Use Tax collection administration should extinguish Taxpayer's sales tax assessments.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation with an office located in Indiana. Taxpayer provides computer hardware, software, and technical assistance to its customers.

The Indiana Department of Revenue (Department) conducted a sales and use tax audit for the 2008, 2009, and 2010 tax years (Tax Years). The Department's audit examination resulted in sales tax assessments on some of Taxpayer's sales of software and on some of Taxpayer's sales of maintenance agreements. Taxpayer protests the assessment of sales tax. A hearing was held and this Letter of Findings results. The Department will supply additional facts where applicable.

ISSUES

I. Sales and Use Tax–Software Maintenance Agreements.

DISCUSSION

IC § 6-8.1-5-1(c) provides that "[t]he notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Pursuant to IC § 6-2.5-2-1, a sales tax, known as state gross retail tax, is imposed on retail transactions made in Indiana unless a valid exemption is applicable. Retail transactions involve the transfer of tangible personal property. IC § 6-2.5-3-2(a). A complementary excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2. Pursuant to IC § 6-2.5-3-4, a taxpayer enjoys an exemption from the use tax for transactions where the sales tax was paid at the time of purchase.

Expanding on the aforementioned statutes, IC § 6-2.5-2-1 provides:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

45 IAC 2.2-4-1(a) further instructs that "[w]here ownership of tangible personal property is transferred for a consideration, it will be considered a transaction of a retail merchant constituting selling at retail unless the seller is not acting as a 'retail merchant.'"

During the Tax Years, Taxpayer sold software, as well as software maintenance agreements that included software updates and computer hardware. Taxpayer protested the Department's assessment of sales tax based upon the audit's citation to 45 IAC 2.2-5-26, but does not provide more details to support its argument.

Indiana law specifically references pre-written computer software in the definition of tangible personal property. IC § 6-2.5-1-27 provides:

"Tangible personal property" means personal property that:

(1) can be seen, weighed, measured, felt, or touched; or

(2) is in any other manner perceptible to the senses.

The term includes electricity, water, gas, steam, and prewritten computer software.

(Emphasis added).

Expanding on IC § 6-2.5-1-27, Sales Tax Information Bulletin 8 (May 2002), 25 Ind. Reg. 3934, stated the general rule that:

[T]ransactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program specifically designed for the purchaser. Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market in the form of tangible personal property and sold or leased in the form of tangible personal property are subject to tax irrespective of the fact that the program may require some modification for a purchaser's particular computer. Pre-written or canned computer programs are taxable because the intellectual property contained in the canned program is no different than the intellectual property in a videotape or a textbook.

However, under Indiana law, provision of services does not constitute the transfer of tangible personal property. Therefore, transactions which involve the provision of services are not subject to the imposition of the sales and use tax unless the law specifically defines the provision of a particular service as a taxable retail transaction.

Some "nested transactions" involve the provision of both tangible personal property and services. A "unitary transaction" is a hybrid sale involving the provision of both tangible personal property and services. IC § 6-2.5-1-1(a) explains that:

"[U]nitary transaction" includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated.

Pursuant to this statutory definition, services are subject to the sales and use tax when they are provided in conjunction with personal property–such as computer software–as a unitary transaction.

Taxpayer argued that, because the software maintenance agreements did not guarantee any software updates, Taxpayer did not have to collect sales tax on Taxpayer's sales of those agreements. Taxpayer based its protest in part on its alleged reliance on Sales Tax Information Bulletin 2 (December 2006). Taxpayer's argument includes an observation that the Department did not publish its updated Sales Tax Information Bulletin 2 until August 4, 2010. Therefore, because the Tax Years precede this publication date, the Department cannot rely upon the updated version.

An earlier version of Sales Tax Information Bulletin 2 stated that:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax. Sales Tax Information Bulletin 2 (May 2002), 25 Ind. Reg. 3595 (Emphasis added) (See also Sales Tax Information Bulletin 2 (November 2000), 24 Ind. Reg. 1192, "Optional warranties and maintenance agreements that only contain the intangible right to have property supplied and there is no certainty that property will be supplied are not subject to sales tax.")

Sales Tax Information Bulletin 2 (December 2006) 20100804 Ind. Reg. 045100497NRA, added further clarification in response to the question of whether maintenance agreements were subject to sales tax:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided. Any parts or tangible personal property supplied pursuant to this type of agreement are not subject to sales or use tax. The supplier of the parts or property to this type of agreement is not liable for the use tax on the parts or property because the supplier is using the material to fulfill the service called for by the terms of the warranty or maintenance agreements. (Emphasis added).

Although the 2006 Bulletin represents a purported change in the interpretation of the imposition statute, Taxpayer correctly points out that Sales Tax Information Bulletin 2 (December 2006), was not published in the Indiana Register until August 2010 and was not effective until that date.

The previous 2002 version of the Information Bulletin did not require the vendor to collect sales tax on the sale of the extended warranties and maintenance agreements; however, the vendor was required to self-assess use tax on any parts supplied pursuant to the terms of the warranty or maintenance agreement. The subsequent 2006 version of the Information Bulletin essentially reversed that requirement. The vendor was required to collect sales tax on the sale of the warranty but was not required to self-assess use tax on any parts supplied pursuant to the terms of the warranty. Presumably the subsequent version of Sales Tax Information Bulletin 2 (2006) was a "change in the department's interpretation of a listed tax" as described in IC § 6-8.1-3-3 and triggered the Department's obligation to either adopt a regulation or publish notice of that "change" in the Indiana Register.

However, in Letter of Findings 05-0438 (August 11, 2006), 20061101 Ind. Reg. 045060474NRA, the Department addressed the question of whether "Software Maintenance Agreements" were subject to sales tax. In the protest at issue in the 2006 Letter of Findings the Department found that these agreements were subject to sales tax on a "prospective basis":

There is no regulation that sets out the department's position regarding the application of sales and use tax to optional warranties. The department first issued Sales Tax Information Bulletin [] 2 concerning Optional

Warranties... on May 2, 1983. In that Information Bulletin, the department explained that if there was a possibility that no tangible personal property would be transferred with the warranty, then there was no certainty that there would be a retail sale and the sales and related use tax did not apply. This position was restated in the revised Sales Tax Division Information Bulletins issued in August 1991, November 2000, and May 2002. Each of the revisions restated the general rule. In the May 2002 revision, it was stated "[o]ptional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Each of the revisions also gave a specific example concerning computer software situations. The examples stated that sales and use tax would apply to the sale of an optional warranty or maintenance agreement in the software situation only if there was a guarantee of the transfer of tangible personal property (updates) pursuant to the agreement.

Computer technology and use has evolved since the issuance of the first Sales Tax Information Bulletin [] 2 on May 2, 1983. Almost all software optional warranties and software maintenance agreements sold today include the automatic provision of updates-sometimes on a day-by-day or week-by-week basis. Purchasers of these agreements have a reasonable expectation that they will receive the updates whether or not the actual contract couches the provision of updates as "optional." The substance of the agreements is that tangible personal property in the form of software updates will be provided no matter what the language of the contract says. The department determines tax consequences by construing the substance of the agreement over the form. Wholesalers, Inc. v. Indiana Department of State Revenue, 597 N.E.2d 1339 (Ind. Tax 1992). In the case of software maintenance agreements or optional warranties, it is clear that the parties presume that tangible personal property in the form of updates will be transferred. Therefore, **the department will construe software maintenance agreements and optional agreements as presumed to be subject to the sales and use tax.** A taxpayer could rebut this presumption by demonstrating that no updates were actually received pursuant to a particular maintenance agreement or optional warranty.

In this particular taxpayer's situation, the department will apply this interpretation prospectively. (Published in the Indiana Register and available at http://www.in.gov/legislative/iac/20061101-IR-045060474NRA.xml.html) (**Emphasis added**).

As of the publication of Letter of Findings 05-0438, the Department fulfilled its obligation under IC § 6-8.1-3-3(b)(2) to give notice of its "change of interpretation" concerning the taxability of software maintenance agreements. As summarized in the Letter of Findings, "The taxpayer's protest is sustained as to the maintenance agreements and optional warranties in this assessment. The taxpayer is advised that in the future, there will be a rebuttable presumption that all software maintenance agreements and optional warranties will be subject to the sales and use taxes."

In the case of the software maintenance agreements, the interpretations set out in the Sales Tax Information Bulletins are irrelevant. Instead the interpretation set out in the above-referenced Letter of Findings governs the issue. The publication of that Letter of Findings met the requirements set out in IC § 6-8.1-3-3. See Carroll County Rural Elec. Mem. Co-op. v. Indiana Dep't of State Revenue, 733 N.E.2d 44, 49 n.5 (Ind. Tax Ct. 2000) ("The publication of the Letter of Findings is a prerequisite for the Department before it can change its position as to the interpretation of a tax, where the change would increase the taxpayer's liability.")

The Department is not required to discern whether Taxpayer's maintenance agreement customers received computer software updates or whether the underlying agreements guaranteed that updates would be provided. The Department presumes that updates were provided pursuant to the agreements.

In this case, the audit found that Taxpayer should have collected sales tax on the software purchased by Taxpayer's customers. The audit also assessed sales tax on Taxpayer's transactions involving software maintenance agreements. Taxpayer has not presented any documents or other evidence showing that Taxpayer's software sales fall outside IC § 6-2.5-1-27's definition of tangible personal property. Neither has Taxpayer presented any documents or evidence to rebut the Department's presumption regarding application of sales tax on sales of software maintenance agreements.

FINDING

Taxpayer's protest is respectfully denied as to both its sales of software and its sales of software maintenance agreements.

II. Sales and Use Tax–Streamlined Sales Tax.

DISCUSSION

Taxpayer also based its protest on its reliance on the accuracy of information provided by a third party sales tax collection service provider. Information provided by Taxpayer indicates the third party sales tax collection service provider's certification under the Streamlined Sales and Use Tax Agreement.

Indiana has been a full member participant of the Streamlined Sales Tax project (SSUTP) and complies with the Streamlined Sales and Use Tax Agreement (adopted 2002 and amended through December 13, 2010) (the "Agreement").

Commissioner's Directive 27 (July 2005), 28 Ind. Reg. 3069, states:

Under the Agreement, Indiana is a participant in a centralized online sales and use tax registration system in cooperation with the other member states. Under this centralized registration system:

A. A seller registering under the Agreement is registered in each of the member states.

B. The member states agree not to require the payment of any registration fees or other charges for a seller to register in a state in which the seller has no legal requirement to register.

C. A written signature from the seller is not required.

D. An agent Certified Service Provider (CSP) may register a seller under uniform procedures adopted by the member states.

E. A seller may cancel its registration under the system at any time under uniform procedures adopted by the Governing Board. Cancellation does not relieve the seller of its liability for remitting to the proper states any taxes collected.

Commissioner's Directive 27 also provides that:

When registering, the seller may select one of the following technology models (i.e., methods of remittance) to remit the Indiana sales and use taxes collected:

A. MODEL 1, wherein a seller selects a CSP as an agent to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases. A seller that has selected a CSP as its agent to perform all of the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases, is a MODEL 1 SELLER.

B. MODEL 2, wherein a seller selects a CAS to use to calculate the amount of tax due on a transaction. A seller that has selected a CAS to perform all of its sales and use tax functions but retains responsibility for remitting the tax is a MODEL 2 SELLER.

C. MODEL 3, wherein a seller utilizes its own proprietary automated sales tax system that has been certified as a CAS. A seller that has sales in at least five member states, has total annual sales revenue of at least $500 million, has a proprietary system that calculates the amount of tax due each jurisdiction, and has entered into a performance agreement with the member states that establishes a tax performance standard for the seller is a MODEL 3 SELLER.

D. OTHER–**No Certified System**–For a seller that calculates its tax, prepares its own tax return, and files and pays sales tax via a system other than a Model 1, Model 2, or Model 3. Select this option if you are not using a CSP or CAS, nor have your own system that is certified by the member states.

(**Emphasis in original**).

As part of the Agreement, IC § 6-2.5-11-2 defines a CSP as "an agent certified jointly by the states that are signatories to the agreement to perform all of the seller's sales tax functions." See also Streamlined Sales and Use Tax Agreement, Art. II, Sec. 203 (November 13, 2002; amended December 13, 2010), available at http://www.streamlinedsalestax.org (defining a CSP as "[a]n agent certified under the Agreement to perform all the seller's sales and use tax functions, other than the seller's obligation to remit tax on its own purchases."). And as IC § 6-2.5-11-10(a) states:

(a) A certified service provider is the agent of a seller, with whom the certified service provider has contracted, for the collection and remittance of sales and use taxes. As the seller's agent, the certified service provider is liable for sales and use tax due each member state on all sales transactions it processes for the seller except as set out in this section. A seller that contracts with a certified service provider is not liable to the state for sales or use tax due on transactions processed by the certified service provider unless the seller misrepresented the type of items it sells or committed fraud. In the absence of probable cause to believe that the seller has committed fraud or made a material misrepresentation, the seller is not subject to audit on the transactions processed by the certified service provider. A seller is subject to audit for transactions not processed by the certified service provider. The member states acting jointly may perform a system check of the seller and review the seller's procedures to determine if the certified service provider's system is functioning properly and the extent to which the seller's transactions are being processed by the certified service provider.

Certification includes an operating contract between a service provider (Contractor) and the SSUTP. As noted above, Taxpayer utilized a CSP for its sales tax collection and remittance. As part of its argument against the subject assessments, Taxpayer cites to Section E.3 of the operating agreement, which states:

In accordance with SSUTA, each Member State and Associate Member State shall review and certify that the Automated System utilized by the Contractor accurately reflects the taxability of the product categories included in the Automated System in accordance with each state's law. To the extent allowed by the law of each Member State and Associate Member State, Member States and Associate Member States shall relieve the Contractor, and any Seller registered under the SSUTA with which the latter contracts, from liability to the state and their local jurisdictions for having charged and collected the incorrect amount of sales or use tax resulting from the Contractor or any of its SSUTA-registered contracting Sellers relying on certification of erroneous data on the taxability of a category of items or transactions.

Contract between Streamlined Sales Tax Governing Board, Inc. and [CSP] (June 2008), available at http://www.streamlinedsalestax.org. (Emphasis added).

In Taxpayer's protest, and also in the administrative hearing, Taxpayer conceded that Taxpayer was "not registered with SS[UTP]." Taxpayer did not provide any additional materials to support its argument for exemption

from sales or use tax under either the Agreement or Taxpayer's contract with the CSP as a non-registered Model 1 Seller.

FINDING

Taxpayer's protest is respectfully denied.

CONCLUSION

Taxpayer's protest is respectfully denied with respect to its sales of software and software maintenance agreements. Taxpayer's protest with respect to reliance on its third party service provider, a certified service provider under the terms of SSUTA and applicable statutes, is also respectfully denied.

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